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SIPDIS

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TAGS: ECON EFIN EINV EAGR KE  
SUBJECT: KENYA: ECONOMIC GROWTH STRONG, POVERTY AND INFLATION  
DECLINING

REFS: A) Nairobi 1981, B) Nairobi 468

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¶11. (SBU) Summary: Kenya's 2006 Economic Survey reports that growth hit a 30-year high of 6.1% in 2006, and the GOK predicts 2007 growth will be between 5.8 and 6.5%. The new National Household Survey showed the national poverty rate fell from 52.3% in 1997 to 49.1% in ¶2006. After peaking in December 2006 at 14.5%, overall inflation in Kenya declined in the first quarter to 11.7% in March 2007. The Central Bank of Kenya (CBK) expects overall annual inflation to drop in 2007, if good rains continue, but fears the impact of any further rises in international oil prices. Underlying inflation, which excludes food, energy and transportation, hovered slightly above the CBK's 5% target for money supply management. Remittances from expat Kenyans, appetite for domestic borrowing and GOK election-year reluctance to raise interest rates may interfere with CBK's efforts to keep money supply growth within limits. The IMF found that overall fiscal and macro-economic performance is good. End summary.

So Much Good Economic News Before an Election

¶12. (U) The Government of Kenya (GOK) released on May 28 the annual pre-budget Economic Survey 2007 prepared by the National Bureau of Statistics (NBS). The Survey indicates that Kenya's economy grew by 6.1% in 2006, the highest rate in 30 years. The hotels and restaurants sector grew fastest at 14%, largely due to 14.9% growth in tourism. The wholesale and retail sector grew 10.9%, while transport and communication rose 10.8%. The Business Daily newspaper reported that consumer spending of Sh1.2 trillion (about US\$16 billion) now dwarfs the GOK's Sh267 billion (about US\$3.9 billion) purchases of goods and services, and that private consumption has become the biggest contributor to the economy over the last five years. The Kenyan shilling has been appreciating against the USD for over 20 months, and is currently at about sh67/USD. Planning Minister Henry Obwocha predicted growth between 5.8 and 6.5% in 2007, depending on whether oil prices stay below \$75/bbl and the shilling remains stable against the dollar. The IMF ResRep issued a statement also projecting over 6% real GDP growth rate for 2007.

Foreign Investors Optimistic

¶13. (U) A member survey by the East Africa Association, an organization of 82 of the largest foreign firms employing over 100,000, with investments of about USD1.5 billion, also revealed significant optimism in the private sector. Three quarters expect

higher sales volumes and profits in 2007, 37% plan to significantly increase their investment, and 50% plan to hire more staff. Sixty percent of the members expect the business situation to improve in 2007, but they noted that crime, poor roads, tax administration problems with Kenya Revenue Authority (KRA), and long delays at the Mombasa port and in the court system remain the greatest threats to foreign investment. Electricity is so expensive and unreliable that 45% of members have invested in their own generating facilities. AIG Global East Africa also predicted no significant shift in macro-economic policies, single digit inflation, and 6% growth in 2007, based on agriculture sector expansion and planned infrastructure improvements. However, growth in agriculture may be limited as a number of regions are reporting irregular rainfall.

#### So Are Kenyan Consumers

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**14.** (U) According to a Steadman Group survey in March, 40% of Kenyans said their living standards had improved compared to last year, while 60% predicted their economic status would improve in the next.

Forty six per cent of consumers believe investment conditions are better than they were a year ago, and 67% think spending on basic products will increase in the year ahead. Forty six per cent of those interviewed are upbeat about future employment opportunities, but more than two thirds of Kenyans believe the Government has not created enough jobs.

#### NBS launches two other key reports

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**15.** (U) The NBS (formerly known as the Central Bureau of Statistics) released the donor-funded Kenya Integrated Household Survey (KIHS), which collected data from May 2005 to May 2006 from over 13,000 households across every district in Kenya. The first Household Survey done since 1999-2000, it and the awaited appendices are a huge trove of statistics that will take months to mine. However,

the Survey's launch in early May featured the "Basic Report on Well-being in Kenya," which documented the reduction of poverty and improvements in economic and social indicators. NBS measured welfare and poverty by consumption of food and non-food items.

**16.** (U) The Well-being Report found the percentage of Kenyans living below the poverty line fell from 52.3% in 1997 to 49.1% in 2006, with urban poverty falling from 49.2% to 33.7%. NBS estimated that 16.6 million of Kenya's population of 35.5 million are poor, with 70% of them in rural areas. NBS estimated that economic growth over the last five years had allowed 2.3 million people to escape poverty. NBS attributed 2002-2006 growth to stable commodity prices, growth in tourism, agriculture and manufacturing, and the impact of development initiatives like the Constituency Development Fund (CDF) on rural areas. However, with 2.5% population growth, NBS estimated that, to further reduce poverty, Kenya will need to sustain growth above 6%, and improve rural roads, electricity, clean water, and food distribution networks. Although the United Nations Development Program's (UNDP) Human Poverty Index (HPI) for Kenya rose slightly from 36.7% in 2004 to 37% in 2006, the HPI measures poverty differently, looking at indicators including access to health, water, and doctors.

#### How the GOK Measures Inflation

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**17.** (U) On a monthly basis, the NBS releases Consumer Price Index (CPI) and inflation rates for Nairobi and 12 other urban centers, and for lower and upper income groups in Nairobi. The "overall" (headline) inflation rate is based on prices for 10 categories of goods and services. The NBS measures "underlying" (core) inflation by removing the volatile categories of food and energy, but the Central Bank of Kenya (CBK) also removes transportation, since it relies so heavily on energy prices. The CBK uses its underlying rate in its monetary policy planning and implementation. Year-on-year (YOY) inflation compares the current month's CPI with the CPI in same month in the previous year. Average Annual inflation compares the average CPI for the last 12 months with the average CPI of the preceding 12 months. This measure serves as the seasonally-adjusted inflation rate, and is less volatile.

#### Overall Inflation Declines in First Quarter

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¶8. (U) Starting in January, the overall inflation rate finally decelerated, partly because of the comparison with drought-driven 2006 inflation. YOY overall inflation fell each month, from 15.6% in December 2006 to 5.9% in March 2007. Average annual inflation declined from 14.5% in December to 11.7% in March. The main change is that food price inflation declined in the first quarter, both YOY and month-on-month (MOM), thanks to good rains and increased supplies. High international oil prices kept fuel and power YOY inflation in the double digits, but it declined from the December peak, as did the MOM increases.

¶9. (U) Low income consumers in Nairobi finally got slight relief in the first quarter, thanks to lower inflation of food, which represents 56% of their expenditure. Overall YOY inflation for the Nairobi low income group fell from 19.2% in December 2006 to 3.9% in March 2007. Inflation in other urban centers, however, declined more slowly.

¶10. (U) In trying to manage the money supply to control inflation, the CBK continues to face remittances estimated at USD 1 billion/year from expatriate Kenyans, many through informal channels. The money supply (M3) grew about 18% YOY in the first quarter, well above the CBK's 10% target, partly because the interest rates offered on T-bills and bonds were too low to mop up sufficient liquidity. GOK domestic borrowing to finance the FY2006/07 budget deficit is running a little above the budgeted amount, contributing to the slow increase of interest rates during the quarter. The average 91-day Treasury bill rate rose from 6.0% in January to 6.3% in March, while the interbank rate increased from 6.4% in January to 6.7% in March.

#### Underlying Inflation Falling Slowly

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¶11. (U) The CBK's underlying inflation rate excludes food, energy, and transportation because of their volatility, and the CBK's goal is to keep the YOY rate below 5%. However, the YOY underlying rate rose to 5.15% in January 2007, fell slightly in February, but again rose to 5.13% in March, the highest level in 18 months. Average annual underlying inflation (seasonally adjusted) rose steadily, from 3.88% in December to 4.18% in March. The CBK is concerned and stated that inflation will hinge on international oil prices, the movements in shilling exchange rate to the US dollar, and success of monetary policy implementation.

#### Economy and Fiscal Performance Look Good

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¶12. (SBU) The IMF told donor country reps in early May that the GOK's overall fiscal performance is good, with both revenues and expenditures slightly below targets. GOK wage expenditures are on track. The GOK can easily absorb the recently-announced increase in teachers' salaries and payment of secondary school tuitions for all students without an increase in public borrowing through tax revenues, donor funding and/or budget offsets. Inflation appears under control, but time will tell how well the GOK is managing the money supply.

¶13. (U) Economic growth, increased savings, and improved communications also have their darker side, like fraud and defenestration. The CBK has warned Kenyans against risking their savings with unsupervised and potentially illegal pyramid and ponzi schemes promising large, quick profits, but many people ignore the warnings. Hundreds of angry investors demanding their returns stormed Development Entrepreneurial Community Initiative's office in Nairobi in May and threw a company officer out an eighth floor window to his death.

#### Budget and Vision 2030 Announcements in June

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¶14. (U) The GOK will make two major announcements in June. Finance Minister Kimunya will deliver the 2007-08 budget to Parliament on June 14. He will explain how the GOK will fund worthy promises like paying the tuition fees for all secondary school students, hiring more teachers, and raising their salaries, while keeping the budget deficit under control. President Kibaki said he would announce in June plans to implement his Vision 2030 initiative (Ref A) to boost annual growth to 10% by 2012 and make Kenya a middle-income economy by investing Sh500 billion (US\$5.4 billion) over the next five years

in 20 flagship projects. The GOK is also in the early stages of planning to issue bonds through the London or New York Stock Exchanges to raise funds for infrastructure investments.

Comment

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¶15. (U) Overall, the GOK's macro-economic management remains good, but inflation and rising government domestic debt remain areas for concern and monitoring. April figures show further declines in inflation, and T-bill rates declined slightly in mid-May, so the good news may continue right up to the December general election.

Ranneberger